ABSTRACT

Globally, the role of Capital market development in promoting economic growth has attracted a lot of attention among scholars, with several studies conducted to ascertain the relationship between capital market development and economic growth. In Kenya, for instance, the vision 2030 development plan aims to achieve an annual economic growth of 10% with an investment rate of 30% to be financed mainly from mobilization of domestic resources. However, the empirical evidence linking capital market development to economic growth has been contradictory and inconclusive as to the direction of influence. In addition, most studies that have been conducted in Kenya have studied the two components of capital market (stock market and money market) in isolation, which does not give a holistic insight into Kenya's capital market. This study analyzed two variables from each component of the capital market. The main objective of this study was to establish the effect of capital market development on the growth of Kenya's economy. The specific objectives of the study were: to determine the effect of domestic credit to private sector on economic growth; to determine the effect of liquid liabilities of Commercial Banks on economic growth; to determine the effect of stock market capitalization on economic growth and to determine the effect of value traded in the stock market on economic growth. The study was significant in providing policy advise.The study was anchored on endogenous growth theory (the Harrod-Domar model). The study employed correlational research design. The study was conducted in Kenya's capital market where annual aggregates of domestic credit to private sector; liquid liabilities; stock market capitalization and value traded, for a period of 23 years from 1990 to 2012, were obtained from the World Bank data base. The data were analyzed by use of multiple regression technique. The results obtained indicate that market capitalization has a significant negative relationship with economic growth, with a co-efficient of -0.18, while domestic credit to private sector, liquid liabilities and value traded have a significant positive relationship with economic growth, with co-efficient of 0.34, 1.25 and 0.08 respectively. The coefficient of determination, R^2, was found to be 0.996, meaning that the four variables explain 99.6% of the variations in economic growth. Generally, capital market development was found to influence economic growth positively. The study recommends that strategies to enhance domestic credit, liquid liabilities and value traded be put in place. Whereas, policies that reduce market capitalization be implemented as a mechanism of stimulating economic growth as envisioned in Vision 2030.